No. 7832

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# United States
# Circuit Court of Appeals
## For the Ninth Circuit.

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JOHN P. McLAUGHLIN, as United States Collector of Internal Revenue, First District of California,
*Appellant,*

vs.

COOS BAY LUMBER COMPANY, a corporation,
*Appellee.*

## BRIEF FOR APPELLEE.



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## BRIEF FOR APPELLEE.

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I.

**Corrected statement of case and exposure of appellant's unfair and unjustified initial argument that the stipulated facts do not support the judgment.**

Beginning on page 3 of appellant's brief, hereinafter referred to as the "Government's brief", a somewhat detailed review is made of the transaction involved in the issuance of the stock in question with, however, the omission of an important agreed and stipulated fact, namely,

**That the reorganization plan provided not that the bondholders' committee should receive the issue of stock from the plaintiff corporation but that the stock should be issued directly to and held only by voting trustees named by the investment bankers pursuant to said plan.**

This is the allegation of paragraph V of the complaint (R. 3) as amended and stipulated to by agreed amendment and stipulation paragraph 3 (R. 40). This above mentioned amendment and stipulation in this regard reads as follows:

> "And except as so amended the allegations of paragraphs V and VIII (of the complaint) are true." (R. 40.)

The amendment of the complaint as thereinbefore in this paragraph 3 (R. 40) stated, amended the error of the complaint in stating the manner of selecting the voting trustees and is not important and does not affect the basic question involved in this appeal. The amendment was that the trustees were named by the investment bankers and not by the bondholders—an immaterial error also made by the Government's brief, page 8.

We thus see that this corrected statement of facts eliminates the necessity of further answering the "shabby" attempt on the part of the Government as set forth at pages 12, 13, and 14 of its brief to argue that the agreed statement of facts does not support the judgment. The writer of this brief describes this argument of the Government as "shabby" advisedly.

There was no dispute when the case was tried in the court below as to the facts involved and both counsel for

the plaintiff and the defendant there properly considered the stipulated facts as presenting the question and issue discussed in the Government's brief following the italicized title at page 14. On page 15 of this portion of its brief it is admitted that there is no dispute on the facts.

The Government's own Bill of Exceptions and Assignment of Errors show that the only issue before this Court is one of law, namely, whether as a matter of law it can be said that there was a transfer of a right to receive stock where the stock was to be and was issued directly to and held only by the trustees. The Bill of Exceptions in this regard states:

> "The defendant moved for judgment in his favor, and further moved the Court to conclude from the stipulated facts that *as a matter of law** the bondholders referred to in said Stipulation of Facts had a right to receive the stock issued in consideration for their bonds and transferred to the newly created trustees such right, and that said transaction constituted a taxable transaction." (R. 52.)

Paragraphs III and V (R. 56-57) of the Government's Assignment of Errors repeat this language of the Bill of Exceptions and confirm the fact that the only issue before this Court is one of law as to whether or not the Court can say that as a matter of law there was a transfer of the right to receive stock under the stipulated facts that the stock was "to be issued directly to and held only by voting trustees."

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*Emphasis and italics throughout this brief are supplied.

If the Government in such tax cases were permitted to "run out" on its stipulations of fact, counsel in these tax cases (which present simply questions of law which both parties desire to be presented with the minimum expense and trouble) would be loathe to accept such stipulations of fact and would require a full and complete trial with its incident burden and expense in every case.

It is rather amazing that the Government which made no request for findings of fact should be contending that the agreed statement of facts does not constitute the findings of fact of the Court. This Court has held that the submission of a case on agreed statement of facts is a sufficient stipulation for waiver of jury and "that the agreed statement is in the nature of a special verdict, and that on writ of error the Court will consider the sufficiency of the agreed statement to support the judgment.'' *Greer-Robbins Co. v. United States,* 19 Fed. (2d) 841-842. The statement in the Minute Order for Judgment by the trial court (R. 49) that "the case having been submitted on stipulated facts, no findings of fact or conclusion of law are necessary" can have no other meaning than that the Court in effect adopted the stipulated facts as its findings of fact. We have pointed out that the stipulated fact "that the stock was to be issued directly to and held only by the voting trustees,'' is sufficient to sustain the judgment.

We ask, therefore, that the Court dismiss as improper and ignore that portion of the Government's brief, pages 12, 13 and 14 which in effect attempts to repudiate the agreed statement of facts presenting, and accepted by counsel and the court below as presenting, the issues in-

volved in the remaining portion of the Government's brief, i.e., pages 14 to 23.

So that the Court might have a little more complete picture of the background of the facts under which the taxes sued for were collected, we might mention here that the additional assessment, for which the taxpayer obtained judgment of refund in the court below, occurred in connection with the taxpayer's claim for refund of the amount of original issue stamps erroneously fixed to the no par value common stock of the Coos Bay Lumber Company and to the second preferred stock. The taxpayer's position under the claim for refund was allowed by the Government but the Government for the first time, more than two years after the reorganization had been completed, invoked the theory involved in the present case to the effect that the bondholders had in legal effect transferred the right to receive the stock which was issued to the voting trustees although the plan of reorganization, as noted above, provided that the stock be issued directly to said voting trustees. The full account of this original claim for refund by the taxpayer is given in paragraphs X to XVII (R. 6 to 11) as admitted by answer paragraphs IX to XIII (R. 36-37).

## II.

Brief Summary of facts and question presented.

Where the bondholders of a corporation surrender their bonds to the corporation issuing certain shares of stock directly to designated trustees with no right in a non-consenting bondholder to cause the stock to be issued to himself, is there a transfer of the legal title to a right to receive the stock which is subject to the federal transfer stamp tax act imposing a tax liability on the transfer of legal title to shares of stock or of the right to receive same? In other words, under such circumstances is there in contemplation of law the transfer of a right to receive stock which the bondholder never had?

The doctrine that there can be a transfer of the legal title to a right to receive stock IN CONTEMPLATION OF LAW where there is no such right in fact is confined to the situation where the party furnishing the consideration for the issuance of stock to a third person is A CORPORATION transferring its assets upon which the law imposes the obligation in the first instance to receive the stock.

Here the bondholders of the Coos Bay Lumber Company were acting as individuals unencumbered by any rule of law requiring a corporation transferring all of its assets to receive in itself the consideration therefor.

The former bondholders received the voting trust certificates or exactly the thing of value for which they contracted. The certificates of stock and legal title thereto were issued originally to and held only by the voting trustees who were the same persons who formerly held legal title to the bonds, i. e., the Bondholders' Protective Committee.

The facts involved in the present case may be summarized as follows: Outstanding bonds of the Coos Bay Lumber Company had come into possession of a bond-

holders' committee. The latter entered into a reorganization agreement with the Coos Bay Lumber Company which provided that the Company would issue its first preferred and common stock directly to a group of trustees for the former bondholders (which trustees were the same persons constituting the bondholders' committee) in consideration of the surrender by the committee to the Company of the bonds held by it and issuance by the trustees of voting trust certificates to the former bondholders. There was in fact no time when any persons, other than the trustees, had a right to receive this issue of stock.

This case as all tax cases must be approached with the familiar rule of judicial construction of such taxing statutes, namely, that they must be construed liberally in favor of the taxpayer and if there is a doubt in the meaning of the statute that doubt must be resolved against the Government and in favor of the taxpayer. *Burnett v. Niagara Falls Brewing Company*, 282 U. S. 648, at 654; *U. S. v. Merriam*, 263 U. S. 179 at 187-188.

The pertinent portion of the taxing statute in question imposes a stamp tax liability "on transfers of legal title to shares or certificates of stock, or to rights to subscribe for or to receive such shares or certificates" (26 U. S. C. A., Section 901 Schedule A—appendix Government's brief page i). Accordingly there must have been a transfer of legal title to shares or a transfer of the right to receive the same for the Government to sustain its position. The statute is so clear in this regard it is not even necessary to resort to the above mentioned rule of construction against the Government to support our case.

Since the filing of the Government's brief, the United States Supreme Court has decided the case of *United States v. Raybestos-Manhattan, Inc.* under writ of certiorari granted May 20, 1935. The Court of Claims decision in this case is cited in the Government's brief at page 20 along with a number of other cases. The Supreme Court decision was rendered on November 11, 1935, opinion by Mr. Justice Stone. The case may be found in the issue of the "United States Law Week" for November 12, 1935, page 29.

In this *Raybestos-Manhattan case* there was a consolidation or merger under the laws of New Jersey whereby the Raybestos-Manhattan Company, a New Jersey corporation, acquired all of the assets of the Raybestos Company, a Connecticut corporation and the United States Asbestos Company, a Pennsylvania corporation, in consideration whereof the New Jersey corporation issued an agreed number of its shares of stock to the stockholders of the old Connecticut and Pennsylvania corporations. Despite the provision in the contract of merger that the New Jersey corporation would deliver "to the Connecticut Company (likewise to the Pennsylvania Company) *or its order*" the required number of shares of stock, Mr. Justice Stone stated as follows:

> "The government and the taxpayer are not in accord as to the precise interpretation to be placed upon the contracts which resulted in the consolidation, but accepting the taxpayer's contention for purposes of decision, we assume that it was agreed by all concerned that the shares of petitioner were to be issued directly to the stockholders of the two

> corporations without further intervention by the latter."

We must keep in mind, however, in the consideration of this *Raybestos case* decision by the Supreme Court that it is confined solely to the facts there involved, namely, to a situation where an old *corporation* transfers all of its assets to a new corporation in consideration of issuance of shares from the new corporation to the stockholders of the old **without anything of value such as voting trust certificates given to the old corporation.** When we realize that the party furnishing the consideration, that is the old corporation, was in contemplation of law required to receive in itself the consideration for a transfer of its assets, the case is readily distinguishable from the case at bar. That the Supreme Court had in mind this distinction is clearly shown in the following statements in the opinion:

> "The new shares could not lawfully be issued to any other than the grantor corporation without its authority, and that authority could not be exercised for the benefit of third persons other than its own assenting stockholders. * * *
>
> It (the statute) embraces the more general one, inseparable from the transaction by which the obligation to issue the stock was created and *which inhered in the two corporations by operation of law.*"

In the case of the Coos Bay Lumber Company, the bondholders could do anything they wanted to with the bonds. The bonds were simply like money which could be used to buy stock to be issued to the persons designated.

The fact that the bondholders were asked to indicate their assent to the contemplated stock issue did not give them, themselves, the right to receive the certificates. The plan of reorganization expressly provided to the contrary. Under the plan of reorganization all the dissenting bondholder could do was to "withdraw (his) bonds on the terms stated in the Deposit Agreement" (R. 43). The terms stated in the Deposit Agreement for the withdrawal of the bonds were simply that the withdrawing or dissenting bondholder pay the pro rata share of the expenses of the Bondholders' Protective Committee already incurred (Paragraphs Fourth and Second of Deposit Agreement, Exhibit "A", R. 20 and 17, respectively). Any of the first preferred and common stock not so issued to the trustees under the plan was to be cancelled. (Plan and agreement paragraph 2—R. 44—Government Brief, p. 7.) It can not be said, therefore, that the bondholders had any right to have the certificates of stock issued to themselves when the plan of reorganization expressly denied this right.

In the *Raybestos case* it may be admitted that the issuance of stock to the stockholders of the old corporation was a mere short cut. It cannot be successfully contended, however, that the issuance of the stock to the voting trustees in the case of the Coos Bay Lumber Company was such a mere short cut. It was an essential part of the reorganization scheme. *We cannot ignore that the reorganization contracts and particularly the stock trust agreement Exhibit "B"* (R. 24) *show that the very nature of the transaction was to maintain control of the affairs of the corporation through election of directors by others than the former bondholders.* This agreement

provided that the stock would not be delivered to the holder of the voting trust certificate unless at least seventy-five per cent in aggregate value of holders of said trust receipts so requested. The stock was so tied up until January 1, 1932, or approximately four years after the consummation of the plan.

The situation is in effect no different from that in which a father, desirous of making a gift to his son, takes $1,000.00 of his own cash to a corporation, pays it over the counter and has a certificate of stock issued to his son. We do not believe that the Government will contend that the recent decision of the Supreme Court in the *Raybestos case,* supra, can be extended to impose not only an original issue stamp tax upon such a purchase by a father but also a transfer stamp tax upon the imaginary transfer of a right to receive stock in the father which never existed. As a matter of fact, even at a time when the Bureau of Internal Revenue was insisting that an obligation for transfer stamp taxes arose in the old and new corporations setup, like the *Raybestos case,* the Bureau did not contend that there would be a tax in such father and son transaction.

We quote the following report from O. D. 176, 10-21-320 S. T.:

> "*A* conveyed to a corporation several parcels of real estate which he owned individually. The corporation was capitalized for $500,000, the same being represented by 5,000 shares of no par value stock, of which 1000 shares were issued to each of his five children. Held that since there was no privity of contract between A and his children, and under the terms of the contract which A had with the corpora-

> tion the stock was in the first instance to be issued to the children, hence A had at no time any right to receive such stock, and therefore could make no taxable transfer of such right."

Until the decision by the Supreme Court in the *Raybestos case,* supra, in the great majority of cases, the lower courts (where there was this new and old corporation merger transaction whereby the assets of an old corporation were transferred to a new corporation and the stock was eventually acquired by the stockholders of the old corporation) had refused to find a transfer unless the agreement between the old and the new corporation or the agreement of reorganization and merger expressly gave the power to the old corporation itself to cause the certificates first to be issued to it. As a matter of fact even the contract of reorganization in the *Raybestos case,* as quoted in the opinion of the court below, apparently gave to the old corporation the right to direct whether the stock should be delivered to the old corporation or to its order, i. e., its stockholders. Quoting from the opinion of the court below in this *Raybestos case* we find the following statement in this connection:

> "The selling corporation (the old corporations) were the ones who had the right to receive the consideration (stock) for their assets and business sold to plaintiff (the new corporation) and these (old) corporations, when they transferred their assets to plaintiff, directed that the stock of the plaintiff be delivered '*to the Company or upon its order*'." (10 F. Supp. 130, 136.)

There is only one corporation involved in the present reorganization or transaction, namely, the Coos Bay Lum-

ber Company. Its name before the reorganization was Pacific States Lumber Company. By the change of name and increase of the authorized capital stock to permit the exchange for the bonds there was simply a continuation of the old company. This, of course, is not contested by the Government. The bonds were surrendered to the same company which was the obligor under the bonds and the same persons who had constituted the bondholders' committee holding legal title to the bonds received the legal title to the shares of stock issued in exchange.

Even if there were a concept of law requiring former bondholders, who have retained simply an equitable interest in their bonds deposited with a committee, to receive something of value in exchange for the surrender of the bonds, this has been accomplished in the Coos Bay Lumber Company's case. The former bondholders received voting trust certificates which admittedly were things of value. The Bondholders' Protective Committee which held legal title to the bonds became the voting trustees to whom the certificates of stock were issued. In a very real and practical sense, as noted above, the bondholders' committee, continuing as voting trustees, maintained the desired control of the Company.

## III.

**At the time the bonds were deposited and also at the time the stock was issued there was no transfer stamp tax on the transfer of bonds. There was no such tax until the Revenue Act of 1932. The Government cannot justify its position by reason of the fact that the law designedly omitted taxing transfers of bonds.**

The agreed statement of facts shows that the bonds were deposited with the Bondholders Protective Committee giving to the committee legal title to the bonds under agreement dated September 18, 1925 (R.—Exhibit "A"—13 et seq.). At this time (Sept. 18, 1925) there was no plan of reorganization or issuance of stock under way. Certainly at this date the Government does not seek to justify the arbitrary assessment that the taxpayer is suing to recover because the law itself did not then provide for a stamp tax liability on a transfer of bonds. Yet we may hazard a doubt that this assessment would have been made had there been a transfer tax liability on bonds at the time. Certainly there were enough taxable transactions which were created or made possible to rebut any idea that the Government was being defrauded of revenue. When the stock was issued, original issue stamps were paid; upon transfer of voting trust certificates, transfer stamps were imposed; if the trustees had been changed, transfer stamps on the transfer of the stock to new trustees would have been affixed; when the trust was terminated, transfer stamps on the transfer of the stock to the holders of the voting trust certificates were imposed. Under such circumstances it can hardly be said that there is any justification in public policy in creating as a matter of law a fictitious transfer of a non-existent right to receive stock in order to increase revenue.

## IV.

**Discussion of two cases decided the same day by District Court in Massachusetts illustrating the difference between the situation where a reorganization is effected of an old corporation whereby the stock of a new corporation is issued to the stockholders of the old corporation, in which case the Supreme Court has recently held a taxable transfer occurs, and the situation presented in the present case where only one corporation is involved and the parties furnishing the consideration for the issuance of stock to others acquired voting trust certificates.**

The Government's brief cited no cases, and we know of none, which have imposed a double stamp tax liability because of a transfer found to exist as a matter of law in any other situation except that of an old and new corporation setup as found in the *Raybestos case.* Furthermore at least one decided case (*Consolidated Equities, Inc. v. White*—discussed infra) has very definitely refused to find a transfer of a right to receive stock as a matter of law where none existed in fact in a transaction involving none of the limitations imposed by the concept of law that a corporation surrendering its assets must receive the consideration therefor. On June 17, 1934, Judge Brewster for the United States District Court of Massachusetts decided two cases which very pointedly illustrate and support the position taken by the Coos Bay Lumber Company. These two cases have the same title and were decided the same day, although reported in different volumes of the Federal Reporter. *Consolidated Equities, Inc. v. White,* 7 Fed. Supp. 851 and *Consolidated Equities, Inc. v. White,* 9 Fed. Supp. 145 which, for convenience, we refer to, respectively, as The Voting Trust Case and The Old and New Corporation Case.

In the Voting Trust Case, 7 Fed. Supp. 851, brokers offered for sale at a stated price trust certificates representing shares in an investment corporation. A customer electing to purchase sent the purchase price to the broker who in turn paid it to the corporation, *whereupon the corporation issued shares to voting trustees* who thereupon instructed the transfer agent of the corporation and of the voting trust to issue to the purchaser voting trust certificates for the number of shares purchased and paid for. Original issue stamps were admittedly paid and due on the issue to the voting trustees but the taxpayer corporation contended that no *transfer* stamps were due since the person furnishing the consideration for the issuance of the stock never had the right to receive the stock or the certificates which were issued to the voting trustees and hence transferred nothing to them. The Court upheld the taxpayer's contention saying:

> "It is obvious that what the customer of the broker purchased and what he received was a certificate representing a beneficial interest in stock which had been originally issued to voting trustees to hold for the benefit of the subscriber. This transaction involved no transfer of legal title to the shares, nor to any right to such legal title either from purchasers to trustees or from trustees to purchasers. If the theory of the government that the purchaser became a shareholder by virtue of his payment to the broker of the purchase price be adopted, the voting trustees held the stock for the sole benefit of the purchaser and purchasers' interest was represented, and intended to be represented, by the voting trust certificate. *No transfer actual or constructive, from the purchaser was necessary to vest the legal title in the voting*

*trustees.* Union Trust Co. of Pittsburgh v. Heiner, 26 F. (2d) 391." (7 F. Supp. 851.)

This is exactly the situation involved in the Coos Bay Lumber Company's transaction. The bondholders, instead of using money to obtain the issuance of stock to voting trustees and obtain the voting trust certificates, used their bonds as the purchase price. All that they received and all that they ever had a right to receive was the voting trust certificates. As noted before in this brief the plan of reorganization under which the stock was issued gave no option to the bondholder whether he would have the stock issued to himself or to voting trustees but his only option was to consent to have the stock issued to the voting trustees and accept the voting trust certificate or withdraw his bonds. In other words, he could either purchase the voting trust certificates or keep his money (bonds) (R. 43).

On the same day in the Old and New Corporation case, 9 F. Supp. 145, Judge Brewster held that where a new corporation is formed, pursuant to a plan for a consolidation of three old corporations and the stock of the new corporation was issued directly to the stockholders of the old corporations, both original issue stamps and transfer stamps should be affixed. While the plan of reorganization indicated that the old corporations had expressly been given the power to direct whether they would in the first instance receive the stock, Judge Brewster in his opinion went further and indicated the same position taken by Mr. Justice Stone when he said:

"The plaintiff issued its shares under the laws of Massachusetts which require all issued stock to be

paid for in cash, property or services. It is clear that plaintiff's stock was to be paid for, not in stock of the old corporations, but in the assets of those corporations. It follows that the corporations, and not their stockholders, were in the first instance entitled to the stock of the new corporation. If the stockholders became entitled to this stock, it was because by votes of the old corporations the right to receive the stock shifted from the corporations to their respective stockholders. Was this a transfer, taxable under Title VIII, Schedule A(3) of the Revenue Act of 1926?

"The plan of consolidation *in legal contemplation* involved an exchange of assets for capital stock and a distribution in liquidation among the stockholders of the old companies of the new stock thus acquired. To accomplish this end, the old corporations took a short cut by directing the new corporation (the plaintiff) to issue the stock directly to the stockholders of the old corporations in the same proportions as would have obtained if the old corporations had made the liquidating distribution." (9 F. Supp. 145 and 146.)

While Judge Brewster then indicated that a contrary result might have been reached in accordance with *Minnesota Mining & Manufacturing Company v. Willcuts*, 2 Fed. Supp. 789 and *Westmoreland Coal Co. v. MacLaughlin*, 8 F. Supp. 963, nevertheless, in view of the above quoted language it seems clear that the Court must have had in mind some concept of law requiring in legal effect that a corporation transferring its assets in consideration of the issuance of stock in a new corporation to its stockholders makes a transfer of the right to re-

ceive stock. We thus see that on the same day and by the same Judge we have decisions illustrating the difference between the Coos Bay Lumber Company's claim and the old and new corporation setup involved in the *Raybestos case.*

The Voting Trust Case, 7 Fed. Supp. 851, was appealed by the Government to the Circuit Court of Appeals but the judgment for the taxpayer was affirmed. There was no appeal in The Old Corporation New Corporation case.

The opinion of the Circuit Court of Appeals affirming this judgment in favor of the taxpayer in the Voting Trust Case is found in 78 Fed. (2d) 435. The case was not tried in the court below on stipulated facts and consequently findings of fact were necessary. However the Court on appeal sustained the lower court's finding that the purchasers bought voting trust certificates and not rights to receive stock which could be said to be transferred to the voting trustees. This, of course, was just what occurred in the case of the Coos Bay Lumber Company. As noted above, all that the bondholder could require in case he assented to the plan was the delivery of voting trust certificates for his interest as provided in the stock trust agreement Exhibit "B" (R. 24) under which agreement it was stipulated that all of the first preferred and no par value common stock was held. (Paragraph 5 of Stipulation of Facts R. 40-41.) While the Circuit Court of Appeals recognized a liberal principle in favor of the government that substance rather than form should be considered, nevertheless, the Court refused to extend the doctrine of the old corporation new corporation cases against the taxpayer. The Court said:

"It is true, as the Collector contends, that in matters of this sort the statute requires that substance rather than form shall be considered, and that 'all transfers of legal title to shares or certificates whether technical sales or not' are taxable; (Provost v. U. S., 269 U. S. 443, 458; Goodyear Co. v. U. S., 273 U. S. 100) *but this does not warrant imputing to transactions a character substantially different from what they in fact were in order to make them taxable.*" (78 Fed. (2) 436.)

We correct at this point an apparent misapprehension or mistaken reliance found in the Government's brief regarding the issue of the 10,000 shares of second preferred stock of the Coos Bay Lumber Company in exchange for all of the former *stock* of the company. On pages 17-18 and 21 of its brief the Government argues that since the taxpayer accepted without contest the assessment of transfer stamps on this issue of second preferred stock therefore the taxpayer has in effect admitted the propriety of assessing transfer stamps on the *bond* transaction. This, of course, is an error that is easily exposed. As we have shown at the time of the transaction involved there was no statute imposing a stamp tax liability on the transfer of bonds or the right to receive the same. However, there was at all times a transfer stamp tax liability with regard to stock. Since the 10,000 shares of second preferred stock were issued to persons other than former stockholders there was in effect a transfer by the former stockholders of the shares of stock. Either it would have been necessary to affix the transfer stamps to the old shares surrendered or to the new issue. As we pointed out earlier in this

brief, the Government's position cannot be sustained on the theory that the Revenue Act at the time of the transaction involved did not cover the transfer of *bonds.*

On page 21 of the Government's brief following the erroneous analogy of the 10,000 shares of second preferred stock the Government cites the recent case of *Founders General Corp. v. Hoey,* (S. D. N. Y.) Vol. I; Prentice Hall, 1935, p. 1980. This case is clearly distinguishable from the claim of the Coos Bay Lumber Company since the Founders General Corp., there, had already *subscribed* for stock in an issuing corporation which was later to be delivered. Before delivery date, however, the Founders General Corp. designated a third party nominee to receive the stock. Obviously there was a transfer of an *existing* right to receive stock and transfer stamps were properly required. The District Court in this last mentioned case very clearly indicated that unless the taxpayer corporation had at some time possessed the right to receive stock it would not have upheld the tax, and furthermore, pointed out that even if the parties could have accomplished the same result by a different method this would not justify the tax. The Court said:

> "But the transaction as actually carried out did not take this form, although it accomplished the same result and in the matter of stamp duties the form is all important. United States v. Isham, 17 Wall. 496. The tax cannot therefore be sustained on the theory that in legal effect the transaction was the same as though the plaintiff had taken legal title to the shares and transferred them to its nominee. But it can be sustained, in my opinion, on the theory that the nomination of Benton & Company as the per-

> son to whom the certificate was to be issued, falls within the exact letter of the statute taxing 'transfers of legal title to * * * rights * * * to receive such shares or certificates.' *Prior to such nomination the plaintiff had the right to receive the shares and by its nomination its right was transferred to its nominee.*"

We cannot believe that the Supreme Court in the *Raybestos case* intended to overrule its decision in the case of *United States v. Isham,* 17 Wall. 496, cited in the above quotation. It is one thing for the Court to hold that as a matter of law an old corporation has the right to receive in the first instance the shares of stock in a new corporation issued in exchange for its assets and then hold that in *legal effect* there has been a *formal act* permitting the imposition of an excise tax, but quite another thing to extend this doctrine to create a direct tax on the mere ownership of property. The constitutional objection of such an extension of the doctrine cannot be ignored. This constitutional objection we shall take up in the following concluding section.

## V.

**The Stamp Tax can be upheld only as an excise tax since it does not apply the apportionment as required in Article I, section 2, clause 3 of the Constitution of the United States.**

**If the stamp tax is construed to apply simply by reason of the ownership of property with the potential power to transfer stock, which power is not in fact exercised, then it becomes a direct tax upon the property itself and must fall under the constitutional objection above.**

In our brief in the lower court we simply suggested that the statute if construed to apply to the situation where there has been neither a right to receive stock nor a transfer of the same, then it would be subject to grave constitutional objections. Earlier in this brief we pointed out the absurd result that would follow from the logical application of the Government's contention where a father would be subject to a transfer stamp tax simply because he owned and possessed the money which was used as consideration for the issuance of stock directly to his son. Yet on principle we fail to see any difference between this father and son relationship and the situation where bonds instead of money are used for the issuance of stock. Congress certainly cannot pass a statute directly taxing the ownership of property unless the tax is apportioned according to population. (See e. g. the historical second income tax cases *Pollock v. Farmers Loan and Trust Company, etc.*, 158 U. S. 601.)

The Supreme Court has held that such a stamp tax on a memorandum or contract of sale of a certificate of stock is an excise tax and not a direct tax. *Thomas v. U. S.*, 192 U. S. 363. In this case the Court said:

> "The sale of stocks is a particular business transaction in the exercise of the privilege afforded by the laws in respect to corporations of disposing of property in the form of certificates. The stamp duty is contingent on the happening of the **event** of sale, and the element of absolute and unavoidable demand is lacking." (192 U. S. 363, 371.)

It would seem to take little argument to show that if there has been no **"event"**, i. e., no transfer of a right to receive stock, then there has been no act or privilege which has been exercised that will justify the tax. However, if the Government arbitrarily claims that there has been a transfer of a right to receive as a matter of law where there is none in fact, then the tax becomes a direct tax upon the property itself or the individual owning the property himself and falls within the constitutional objection.

Of course we contend that the clear wording of the stamp tax statute in question imposing a stamp tax "on transfers of legal title to shares or certificates of stock * * *or to right to receive such" expressly prohibits the Government from imposing the tax in question. However, the above constitutional objection is made to show the fallacy of the Government's argument that there can be a transfer of a right that never existed.

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## CONCLUSION.

In conclusion therefore we submit that the agreed statement of facts setting forth fully the transaction involved in this dispute and particularly the stipulated fact that the plan of reorganization under which the stock

was issued "provided not that the bondholders' committee should receive the issue of stock from the plaintiff, but that the stock should be issued directly to and held only by the voting trustees" fully supports the judgment for the plaintiff and that the same should be affirmed.

Dated, San Francisco, California,
November 26, 1935.

Respectfully submitted,

Lyman Henry,
*Attorney for Appellee.*